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Before the
Federal Communications Commission
Washington, DC 20554

In the Matter of Federal-State Joint Board on Universal Service	)	CC Docket No. 96-45
	)	

REPLY COMMENTS OF AIRTOUCH COMMUNICATIONS, INC.

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AirTouch Communications, Inc. (AirTouch)[1] hereby submits the following reply comments regarding the *Notice of Proposed Rulemaking* in the above-captioned proceeding.[2]

SUMMARY

In several important areas, there is broad agreement among the parties filing in this proceeding. In particular,

- The current system of universal service is needlessly costly and inefficient with respect to both the way in which support is allocated and the way in which subsidy revenues are collected.[3]
- Fundamental reform is needed to make universal service policy compatible with competition. The current system of cross subsidies and uneven obligations across telecommunications market participants both distorts competition and is threatened by it.[4]

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1 AirTouch is a wireless communications company with interests in cellular, paging, personal communications services, satellite and other operations.

2 *Notice of Proposed Rulemaking and Order Establishing Joint Board*, CC Docket No. 96-45, FCC 96-93 (released March 8, 1996) ("*Notice*").

3 *See, e.g.*, Sprint Comments at 19-20; AT&T Comments at 2; Southwestern Bell Telephone Company ("SWB") Comments at 1-4; Bell Atlantic Comments at 2.

4 *See, e.g.*, Western Wireless Comments at 10-11; LDDS Comments at 2-3; AT&T Comments at 1-10; Bell Atlantic Comments at 4-5.

- The current system should not be expanded to new services before it is overhauled. At present, only core telephone services — residential dial tone — should be subject to universal service support.[5]

- Key elements of universal reform include: (a) making both support and contribution flows explicit and accountable; (b) narrowing the set of subsidy recipients through targeting to ensure only those users for whom there is a public interest in subsidizing in fact receive subsidies;[6] and (c) raising the subscriber line charge (SLC) to members of non-targeted groups.

Despite broad overall agreement on the shortcomings of the current system and the fundamental directions of needed reform, there are important differences in the proposed remedies. At the most basic level, the cumulative effect of the proposals made by several LECs would be a system that severely limits the ability of any provider other than an incumbent LEC to receive universal service support, while placing the burden of providing universal service contribution largely on non-LECs. Notably lacking in most LEC comments is a discussion of bringing competitive market forces to bear in determining who receives universal service subsidies.

There are other areas of basic disagreement as well. Wireline carriers and others suggest raising universal service contributions through a tax on gross or net telecommunications revenues.[7] However, the use of gross or net telecommunications revenues as the basis for tax collections is unfair to wireless and other providers with

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5 *See, e.g.*, Vanguard Cellular Comments at 3; Ameritech Comments at 7; Bell Atlantic Comments at 2-3; Sprint Comments at 7-8; BellSouth Comments at 5-6. This is in addition to the services mandated by the Telecommunications Act of 1996 (Pub. L. No. 104-104, 110 Stat 56 (1996) ("1996 Act") for educational and health service organizations.

6 The 1996 Act identifies low-income subscribers and subscribers in high-cost areas as deserving of support. In addition, it calls for preferential rates for schools and health care providers in certain circumstances.

7 *See, e.g.*, NECA Comments at 18; USTA Comments at 24; BellSouth Comments at 15-16; Ameritech Comments at 23; Associated Communications & Research Services, Inc. Comments at 5; NCTA Comments at 23-24; John Stairulakas, Inc. Comments at 17; Wyoming PCS Comments at 4; Idaho PUC Comments at 17; GTE Comments at 16; USTA Comments at 23-25; LDDS Comments at 17-19

significantly different cost structures than traditional wireline carriers. Moreover, by collecting subsidy revenues through a traffic-sensitive charge, the use of a revenues tax inefficiently distorts end-user consumption decisions Instead of adopting this discriminatory and inefficient approach, the Commission should increase the interstate SLC so that non-targeted end-users contribute to the funding of universal service. If the Commission finds that there are reasons not to adopt this proposal, then the Commission should levy a uniform per-minute surcharge on all calling including local exchange, interexchange, and CMRS.

There is also disagreement on the proper role of the states and the degree of state-federal coordination that would be desirable Competition will be thwarted and the public interest harmed if telecommunications suppliers are subject to inconsistent and overlapping universal service policies at the federal and state levels. To avoid such an outcome, the Commission must take the lead in implementing an overall, nationwide policy. The balkanized approach advocated by several of the LECs will confront service providers with a confusing array of different obligations which will make it more difficult to compete effectively, particularly as they attempt to enter the largely monopolized markets of incumbent local exchange carriers

AirTouch submits that the following tasks constitute the fundamental "building blocks" of true universal service reform — reform that will result in a system that does the most to advance the goals of universal service while minimizing its burden on telecommunications consumers and the economy as a whole:

- Design and implement programs that minimize waste in the payment of universal service support, including: (a) conducting impartial cost studies to estimate the true amounts of funding needed to support universal service; (b) making support flows explicit and accountable; (c) targeting subsidy payments; (d) introducing competition into the process wherever possible; and

- Reform the collection of universal service support funds by raising the SLC to non-targeted end-users Failing adoption of this policy, the

Commission should levy a uniform per-minute surcharge on all retail telecommunications services.

I. THE COMMISSION SHOULD ACT TO ELIMINATE WASTE FROM THE CURRENT SYSTEM OF PAYING UNIVERSAL SERVICE SUPPORT

As AirTouch discussed in its initial comments, public policy must be built on the recognition that subsidies do not come free. Even the best-designed program will trigger efficiency losses by distorting consumption and investment decisions because of the need to collect contribution. Thus, it is important to reduce the size of universal service contribution to the maximum extent consistent with meeting universal service policy objectives. This means: (1) not allowing the incumbent LECs to overstate subsidy needs, and (2) designing policy in ways that generate cost savings.

The efficiency costs of raising revenues are not the only reason to avoid excessive subsidy levels. If incumbent LECs receive excessive subsidies they may distort competition by engaging in cross-subsidization. In fact, the 1996 Act recognizes this problem and expressly provides that any universal service support provided to carriers is not to be used to subsidize competitive services. Thus, 47 U.S.C. § 254(k) requires that the Commission "establish any necessary cost allocation rules, accounting safeguards, and guidelines to ensure that [interstate] services included in the definition of universal service bear no more than a reasonable share of the joint and common costs of facilities used to provide those services."[8] The support mechanisms established by the Commission must not violate this clear statutory mandate.

Because raising subsidy revenue is costly, and because of the threat of cross-subsidization, it is vital that incumbent LECs not be allowed to overstate subsidy needs. Cost studies submitted by other parties to this proceeding demonstrate that LECs have, in

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[8] 47 U.S.C. § 254(k). A separate rulemaking is slated to address Section 254(k) requirements.

fact, overstated their needs,[9] and thus the amounts of so-called universal service support received by carriers should be reduced. The overstatement comes from two sources: (a) firms have exaggerated their current costs, and (b) the present system provides too little incentive for cost reduction. This lack of incentives speaks to the importance of the second general point: the need for policy which encourages cost savings.

There are several mechanisms through which policy can, and should, reduce universal service subsidy needs. These mechanisms are discussed below.

A. Build Incentives for Cost Reduction Into the System

It is vital to build incentives for cost reduction into universal service policy. A system under which a carrier is subsidized on a cost-plus or rate-of-return basis is fatally flawed because it provides little incentive for efficient cost reduction.[10] Indeed, it would be neither sound policy, nor consistent with the spirit of the 1996 Act, to support universal service on a traditional cost-of-service basis. Instead, any subsidy payments directly to carriers should be based either on: (1) the results of competitive bidding by universal service providers; or (2) proxy cost models that create price-cap like incentives.[11]

B. Rely on Market Forces in Awarding Subsidy Funds to the Maximum Extent Feasible

In addition to generating incentives for carriers to reduce their costs, use of competitive market mechanisms allows policy makers to choose the least-cost provider

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9 *See, e.g.*, Time-Warner Comments at 8-9, 11-12; Nat'l Assoc. of State Utility Consumer Advocates' Comments at 13-14.

10 *See, generally,* Ameritech Comments at 3-5; *see also* Bell Atlantic Comments at 2, 8-10.

11 In estimating costs with proxy models, the Commission should estimate the forward-looking costs of an efficient provider. This approach will most closely mimic competitive forces, will provide incentives for cost reduction, and will limit the ability of any carrier to use universal service support funds to cross-subsidize other services.

for any given service subject to universal service support. Artificial restrictions on competition to provide service — including limitations on eligibility to receive funds — needlessly increase costs.[12]

The following principles should guide the design of policy for paying out universal service support funds:

- *Where possible, support payments should be made to end-users, not carriers.* This approach promotes competition by letting the end-user choose any carrier providing the supported service. This should lead to lower prices, stimulate cost-reducing and quality-improving innovation, and create greater consumer choice.

- *In those instances where payments to end-users are infeasible, policy makers should use market forces and competition to pick which carrier receives funds.* For example, the Commission might auction the rights to receive universal service support funds in return for agreeing to meet specific service obligations.

- *Ancillary conditions placed on carriers as a condition of eligibility for the receipt of universal service support funds should be kept to a minimum.* By reducing competition in supported services, limiting eligibility will serve to raise costs and reduce the level of provider innovation under the program. Moreover, it will reduce competition in other services by denying economies of scope to entrants.

- *Policy makers must beware of unintended consequences.* For example, the use of broad regions to assess which areas are eligible to receive high-cost support may have the unintended effect of freezing out new entrants who will initially be forced to enter in comparatively limited areas.[13] A CMRS provider, for instance, might be well-suited to serving a high-cost rural area in an otherwise low-cost state. Under the use of statewide study areas, however, this carrier would not be able to draw on universal service support funds to hold prices down to what public policy considers a reasonable level.

- *Support mechanisms should rely on economic incentives (e.g., explicit subsidy payments) rather than regulatory fiat (e.g., orders to carriers to provide service).* Financial incentives ensure that policy makers are aware of the costs of any particular initiative and serve as a safety valve against particularly inefficient policies. In contrast, when carriers are simply ordered to provide service, little information about

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[12] Thus, we disagree with Bell Atlantic (Comments at 3) that new entrants to high-cost areas should not be eligible for universal service support funds.

[13] *See* Bell Atlantic Comments at 8-9, where it is proposed that statewide average costs be used to determine eligibility for high-cost support.

the cost of universal service programs is generated and high-cost, low-benefit programs may persist. Moreover, the use of regulatory fiat inevitably leads to a *quid pro quo*: protection from competition in a particular market or service in exchange for generating subsidy funds.

C. Support Programs Should be Targeted to Help Those in Need of Assistance

By focusing assistance where it is needed, well-designed targeting can reduce the cost of universal service programs and increase their effectiveness in serving those groups that are in greatest need of help. Subsidy programs should be limited to targeted populations and services where there are demonstrated market failures.

D. Do Not Allow LECs to Use Universal Service Policy to Recover Legacy and Common Costs from Other Providers

Several LECs have tried to make the issue of legacy costs or so-called "stranded" investment an issue of universal service.[14] AirTouch believes that drawing this link is inappropriate for two reasons. First, as the primary recipients of universal service support, the LECs have economic incentives to overstate their needs. Claims of stranded investment are just one piece of this strategy. Second, this approach is an anachronistic carryover from the old attitude toward competition in telecommunications markets. The old view held that, as a consequence of natural monopoly cost conditions, competition was antithetical to the public interest. The new paradigm for telecommunications policy recognizes that competition can generate significant benefits, and that public policy should promote competition. Indeed, this paradigm underlies the 1996 Act which takes significant steps to make monopolists open up their markets and has provisions to allow firms to enter into one another's markets. By asking that other providers pay for their past investments, LECs seek to be shielded from competition.

Similar considerations apply to the treatment of common costs. Universal service policy should not serve as a vehicle for incumbent LECs to levy charges on rival

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[14] *See, e.g.*, SWB Comments at 23-25; BellSouth Comments, Attachment at 9.

carriers that may then be used to defray costs that would be incurred by the LECs whether or not they were providing the services ostensibly supported by universal service funds.[15]

E. Seek Other Means of Promoting Subscribership

As the Commission has noted, there are a variety of means to promote telephone subscribership other than subsidies.[16] For example, disallowing disconnect for non-payment of toll or quick dialtone and other low-cost, low-priced alternatives.

II. THE COMMISSION SHOULD COLLECT UNIVERSAL SERVICE CONTRIBUTIONS ON AN EQUITABLE AND EFFICIENT BASIS

Contributions to support universal service constitute a tax levied on telecommunications users and providers. There is a well-developed literature on designing fair and efficient taxation schemes,[17] and the Joint Board should build on the results of this analysis. In particular, the effects of the tax on consumer welfare and competition must be considered fully in designing a new universal service contribution scheme.

Two central questions that must be answered in designing a universal service support scheme: (1) What is the tax base (i.e., who will contribute to universal service

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15 By definition, common costs cannot be ascribed, on the basis of cost causation, to the services being supported by universal service.

16 *See In the Matter of Amendment of the Commission's Rules and Policies to Increase Subscribership and Usage of the Public Switched Network*, CC Docket No. 95-115, *Notice of Proposed Rulemaking*, 60 Fed. Reg. 44296 (August 25, 1996).

17 For a summary of the optimal taxation literature, *see* Anthony B. Atkinson and Joseph E. Stiglitz, *Lectures on Public Economics*. New York: McGraw-Hill, 1980. *See also* Alan Auerbach, "The Theory of Excess Burden and Optimal Taxation." In *Handbook of Public Economics Vol. 1*, edited by Alan J. Auerbach and Martin Feldstein. Amsterdam: North Holland, 1985.

funding and how will *relative* burdens be assessed)?, and (2) what are the tax rates?[18] The remainder of this section focuses on the choice of tax base. This choice should be guided by principles of equity and efficiency.

A. Principles of Equity

There are several approaches by which one might determine who "should" pay the tax. Over the past two centuries, the academic literature on public sector economics has focused on two notions of fairness:[19]

- *The Ability to Pay Doctrine:* This view holds that those parties having a greater ability to pay, should pay more. This principle underlies the U.S. income tax. Application of this approach to the funding of universal service suggests that richer consumers should pay more contribution than others. One might also say that richer corporations should pay more, but this approach fails to recognize that ultimately the burden falls on investors, customers, and workers, and one should examine their respective abilities to pay.

- *The Benefits Doctrine:* This view suggests that tax payments should be in proportion to the benefits derived from the funded programs. Applied to universal service, this approach implies that those who benefit most from universal service policies (excluding, of course, those at whom subsidies should properly be targeted) should make the greatest contribution toward universal service. It is more likely than not, however, that most people do not in their roles as telephone subscribers derive significant benefits from the effects of universal service policy.[20] This conclusion follows from the fact that most subscribers likely do not place many calls to the people who would otherwise drop off the system. Today, universal service is more of a social program than a means of internalizing what might otherwise be network externalities

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[18] The answer to question (2) will follow from the overall program funding needs (which, in turn, are determined by the universal service policy choices discussed in Section I above) and the answer to question (1).

[19] For a survey, *see* Richard A. Musgrave, "A Brief History of Fiscal Doctrine." *See also Handbook of Public Economics Vol. 1*, edited by Alan J. Auerbach and Martin Feldstein. Amsterdam: North Holland, 1985.

[20] Residential and business subscribers in high-cost areas may benefit from the fact that their neighbors are being subsidized, but, of course, they themselves are being subsidized, rather than contributing to the program.

Some might argue that these two fairness-based approaches can be combined along the following lines: People who pay a lot for telephone service must be getting large benefits from the public switched telephone network (PSTN) — if not from universal service policies themselves — and thus have the ability to contribute to the system. The error in this logic is that high payments for telephone services may reflect high prices, rather than high volumes. While high volumes may be associated with greater net consumer benefits, high prices typically are associated with lower consumer benefits.

The mistake in the logic of equating high revenues with high benefits can be seen through the following hypothetical example. Consider two end-users who purchase the same mix of services, but live in different areas and pay different prices for the services. Each subscriber consumes telephone services that they both value at $80 per month. That is, $80 is their maximal willingness to pay for the services. One consumer, however, pays $70 per month for these services, while the other pays $40. Which consumer derives greater benefit from the telephone network? In terms of gross benefits, the two consumers derive the same benefits: $80 per month. And in terms of net benefits, the second consumer does much better. She enjoys net benefits of $40 ($80 - $40) per month, while the first subscriber enjoys net benefits of only $10 ($80 - $70).[21] Using either gross or net benefits, and either the ability to pay doctrine or the benefits doctrine, the subscriber paying $40 per month for telephone services should bear at least as great a contribution burden as the subscriber paying $70 per month. But focusing on the amounts paid for service gives exactly the opposite answer.

One might also conclude that subscribers with higher telephone bills are more able to pay contribution because they are richer. Before reaching this conclusion,

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[21] These net benefits are what economists refer to as *consumer surplus*. Consumer surplus is the standard measure of consumer welfare used in antitrust and other policy analyses.

however, one would need to examine the relationship between subscriber income and their monthly bills. Data from the AT&T non-dominance proceeding suggest that the link is a weak one.[22] Thus, from any perspective, the size of the subscriber's bill (or the size of carrier revenues) is not a particularly good way to tie subscribers' contribution burdens to some notion of how much they "deserve" to pay.

B. Principles of Efficiency

In addition to spreading the burden fairly, any tax policy should strive for efficiency. In designing universal service policy, the Commission should aim to minimize the distortions in economic activity that result from the collection of a given contribution toward the subsidy programs.

This perspective leads to several broad principles:

- *Have as broad a tax base as possible.* This conclusion follows from two facts. One, additional policy instruments provide a greater range of options. Two, the excess burden (*i.e.*, the efficiency loss) of a tax on any one good or service generally increases more than proportionately with the tax rate. In other words, from an efficiency perspective, it is better to have lots of little taxes rather than one big one.

- *Rely on lump-sum taxation to the extent feasible.* A pure lump-sum tax is efficient—the person on whom it is levied can do nothing to affect the amount, and thus there is no incentive for the tax payer to distort his or her actions. In the case of the federal income tax, the use of lump-sum taxation is limited by fairness considerations and the lack of information that would otherwise allow the government to tailor the size of the lump sum to some characteristics of tax payers that they could not otherwise control.[23] As discussed below, a near-lump-sum tax would be a desirable way to raise revenues to support universal service subsidies.

- *Where prices are distorted by the need to raise contribution, the responsiveness of supply and demand to price must be taken into account.* In the simple case where there are no cross-effects of the price of one service on the demand for another, and there are no

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22 *See, generally,* the record developed *In the Matter of Motion of AT&T Corp. to be Reclassified As a Non-Dominant Carrier, Order,* 11 F.C.C. Rcd. 3271 (1995).

23 As long as the lump-sum amount is either fixed or depends only on characteristics that the taxpayer cannot control, the tax creates no distortionary incentives.

income effects, one obtains the familiar inverse elasticity rule associated with Frank Ramsey: relatively greater contribution rates should be charged to services with relatively less responsive demand.[24] It is important to note that the conditions that must be satisfied to give rise to this result are extremely unlikely to be satisfied in practice. The assumption that income effects are negligible likely is a reasonable one because the amounts of money are relatively small. However, the demands for different services are affected by the prices of other services (*e.g.*, the demand for local service depends on long distance rates). Hence, a more sophisticated analysis is required.

- *Do not distort production without a good reason.* Taxes can distort both consumption and production decisions. Because consumers eventually will bear the burden of the tax, it is in some sense inevitable that consumption will be distorted. But it may still be possible — and it is desirable — to keep production efficient. In other words, do not tax intermediate goods (like interconnection and access) unless there is a specific objective that could not be realized by taxing solely final goods.

- *Do not distort competition.* This point is similar to the one above made for production. If two firms can provide substitute services for one another, the means of raising contribution toward universal service should not distort the competition between these providers.[25]

C. Alternatives Bases for Assessing Contribution

From both the ability-to-pay and efficiency perspectives, there is no reason to restrict the tax to the telecommunications sector Thus, universal service programs would best be funded out of general tax revenues Unfortunately, this option is not open to the Commission at this time. Instead, the Commission must limit itself to raising funds from users and providers within the telecommunications sector. This still leaves several dimensions of choice open to the Commission It must choose the basis of assessing the contribution burdens (*e.g.*, per dollar of revenue or per minute) and the services to which these burdens attach. In doing so, the Commission should: (a) seek as broad a tax base as possible, (b) design policies to minimize economic distortions by taking into account

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[24] Ramsey, Frank P. "A Contribution to the Theory of Taxation." *Economic Journal*, Vol. 37 (1927).

[25] Indeed, this is not only sound economics, it is mandated by the 1996 Act.

demand and supply responsiveness, and (c) preserve competitive and technological neutrality.

Consider first the basis of assessing the contribution burdens. While a number of parties advocated the use of service revenues as the base for assessing contribution burdens, they failed to provide a comprehensive analysis of the alternatives.[26] AirTouch believes that it would be more appropriate to assess burdens based on either access lines or minutes of traffic. In order to assess the contribution approaches under consideration herein, it is useful to examine the various approaches through the lens of the equity and efficiency principles that economists have developed.

1. A Tax on Revenues. As mentioned, a number of parties have proposed basing the contribution toward universal service on either *gross telecommunications revenues* or *net telecommunications revenues,* where the latter backs out payments to other telecommunications providers on whose services the tax already has been collected. As pointed out by a number of commenters, the use of a *gross* revenues tax suffers from a problem of double taxation.[27] While the use of *net* revenues avoids this problem and is thus a significant improvement over the use of gross revenues, it is critical to recognize that the net revenues approach still suffers from serious problems. A tax on revenues is essentially a telecommunications sales tax. It impacts end-user prices in the same manner as raising suppliers' costs. Unfortunately, it raises these costs in a way that is neither competitively nor technologically neutral. For carriers with higher prices per unit, it is equivalent to a greater cost increase.

This sort of problem already arises in California, where the California Public Utilities Commission (CPUC) uses an "All End-User Surcharge" (AEUS) to fund state

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[26] *See* n.7 supra.

[27] *See, e.g.*, Ameritech Comments at 23-24. USTA also argues that double-counting must be avoided. *See* USTA Comments at 24.

universal service programs. This surcharge is based on transmission path revenues less access payments to other carriers. All telecommunications customers ("end-users") (except one-way paging company customers) pay the surcharge, and it appears on customers' monthly bills.

Because the surcharge is based on a percentage of the revenues received by the provider of telecommunications services, the providers (and their customers) of newer, more expensive, and more technologically complex services such as cellular pay a disproportionately large share of the surcharge. Because cellular per-minute rates are higher than landline rates, cellular customers pay a higher surcharge than that paid by landline customers, while their telecommunications demands impose a significantly smaller burden on the local network.

Problems of technological and competitive neutrality arise when carriers compete with each other using different technologies to provide differentiated services. Suppose, for example, that two carriers compete with one another using different technologies: one a high-cost, premium service, the other a low-cost, basic service. Suppose that the premium service costs an additional 20 cents per minute, but is worth just this much more to consumers. The two services are thus competitive with one another. Now, suppose a five-percent revenues tax is levied on the two services. This tax will raise the costs of the premium service by one cent per minute more than the costs of the basic service. Consumers will no longer be willing to purchase the premium service when each is priced at cost *plus* the tax

The following hypothetical example illustrates the unfairness of a revenues tax in another way. Consider a national network with three types of service areas: low-cost, medium-cost, and high-cost. Policy makers have deemed that subscribers in high-cost areas are worthy of being subsidized The problem then is how to raise the requisite funds from subscribers in low- and medium-cost areas. Ability-to-pay based

considerations of fairness suggest that a subscriber in a low-cost area should contribute as much or more than a subscriber in a medium-cost area. But consider two subscribers who make the same number of calls per month. Assuming that regulation results in retail prices proportional to costs, the subscriber in the medium-cost area will have a higher bill for any given level of calling. Hence, a contribution based on either gross or net revenues will place a *greater burden on the subscriber in the higher-cost area.*

The final major drawback of this approach is that it relies on traffic-sensitive charges to attain contribution. Because they are traffic-sensitive, these charges can be expected to distort end-user calling decisions, thereby reducing the benefits generated by the PSTN. This problem is a real one, as evidenced by the effects of access charge reform over the past decade and the resulting stimulation of long-distance traffic.

2. A Tax on Minutes of Use. Another basis for assessing universal service contribution burdens is the number of minutes of traffic. Like revenues, the use of traffic volume to assesses contribution burdens results in a system of traffic-sensitive charges. Hence, as with the use of a revenue basis, a per-minute basis will inefficiently distort telecommunications consumption decisions. The result will be diminished social benefits.[28]

A per-minute basis does, however, have a significant advantage over the use of gross or net revenues. Gross and net revenue bases lack competitive and technological neutrality. A uniform per-minute surcharge placed on all telecommunications traffic would not have the non-neutrality problems identified above for gross or net revenues. Moreover, it would also lead to each service bearing a relatively small burden, rather than

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[28] Another possibility for consideration is to assess contribution on a per-call basis. The advantage of this approach is that it would not distort consumers' marginal incentives with respect to the choice of call length in the way that a revenues or per-minute approach would. However, collection of universal service contribution on a per-call basis could be expected to distort consumer choices with respect to the number of calls made. Thus, in choosing among these traffic-sensitive approaches the Commission must balance the different types of distortion.

some services taking on a disproportionately large burden. Further, in contrast to a revenue basis, a per-minute basis would not collect the least contribution from consumers with the lowest cost of service.[29]

3. A Flat Monthly Tax. An alternative approach is to come closer to having a non-traffic sensitive, or lump-sum, contribution assessed on each end-user. This could be accomplished by having each subscriber to the PSTN make a flat monthly payment toward universal service (except, of course, those eligible for subsidies). In contrast to today's system, the payment would be a flat amount paid by the end-user and would be triggered by connecting to the PSTN, rather than presubscribing to an interexchange carrier. This approach is both efficient and fair

Economic theory and empirical evidence indicate that an end-user will make his or her decision whether to connect to the PSTN by considering the full vector of telecommunications prices (*e.g.*, per-month and per-minute local exchange charges, intraLATA toll, and interLATA toll). It can readily be shown that, if all users are identical, then the efficient way to raise subsidy revenue is to levy it on the basic monthly fee and not distort any of the traffic-sensitive charges. This approach maximizes the benefits that the representative consumer enjoys from the PSTN, and maximizes both economic efficiency and the penetration rate

Clearly, actual end-users vary, which raises the possibility that the contribution per end-user also should vary. But on what basis? As proposed here, the monthly charge *would* vary by income level in the following one-step way: Residential end-users below a defined income level would not pay the contribution (indeed they

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[29] Several parties oppose the use of per-minute assessments but do not provide analysis to support their positions. *See* Ameritech Comments at 24, where it favors net revenues and opposes per-minute tax basis on the grounds that it would not be competitively neutral. Ameritech does not explain how it reached this conclusion. Similarly, NCTA states the per-minute charges can give rise to economic distortions (NCTA Comments at 24) but again does not provide any analysis to back up this claim.

would be eligible for universal service subsidies), while end-users above the threshold would pay the fixed monthly contribution. By relying on the criterion used to assess eligibility for subsidies, this approach would not create addition administrative burdens. It is a thus a low-cost way to account for differences in ability to pay.[30] Moreover, it reduces any efficiency losses that might come from disconnects because targeted subscribers — presumably the subscribers most likely to disconnect in the face of price increases — would be exempted from it.[31] Similar considerations apply with respect to high-cost areas.

4. Recommended Approach: Raise the SLC. In summary, the Commission should raise the SLC to provide contribution from non-targeted groups. Failing adoption of this policy, the Commission should levy a uniform per-minute surcharge on all retail telecommunications services.[32] In fact, the Commission may want to combine approaches by increasing the flat charge on end-users while retaining some per-minute mark up. This approach would make sense to the extent the Commission believes that increased burdens should be placed on high-volume callers or that a transition from the current system should be gradual to avoid disruptive shocks.

D. The Services on Which Contribution is Assessed

1. Interstate and Intrastate Services Should be Treated in a Unified Manner. As discussed in our earlier comments in this proceeding, intrastate and

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30 With well-defined eligibility criteria, such a system will account more effectively for differences in ability to pay than will an indirect approach like a net revenues tax. To the extent that there is a lack of correlation between telephone consumption levels (beyond basic hook-up) and income, use of revenues will not tie in well to income.

31 Moreover, Bell Atlantic argues that phasing in annual increases in the SLC of up to 25¢ will not have major impacts on subscribership. *See* Bell Atlantic Comments at 3.

32 Alternatively, the Commission could levy a per-minute surcharge on all services and allow netting out along the lines proposed by others in the gross v. net revenues discussion.

interstate universal service policies must be coordinated.[33] In terms of the basis for assessing contribution burdens, we agree with Ameritech that "[a]ssessing universal service support on both an intrastate and interstate basis is more competitively neutral and would reduce the incentive for providers to route their traffic so as to avoid their support obligations."[34] More generally, without a coordinated, comprehensive approach to overall universal service policy: (1) the incumbent LECs will not be held fully accountable and may continue to reap the benefits of large, implicit cross-subsidies;[35] and (2) carriers like AirTouch may be overtaxed or otherwise caught between two different programs.

With respect to the latter point, as AirTouch and others have previously discussed, CMRS is inherently and jurisdictionally an interstate service and should be subject only to *federal* universal service requirements and funding mechanisms.[36] CMRS is *not* currently a land-line service substitute for a substantial portion of the communications in any state,[37] and thus the states are not allowed to impose intrastate universal service requirements on CMRS providers. If not corrected, the imposition of state universal service requirements will result in a duplicative and discriminatory universal service burden on CMRS providers.

As several state commissions have argued, the Commission should take the lead in setting universal service policy generally, because universal service is largely a

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33 *See* AirTouch Comments at 2-5.

34 Ameritech Comments at 22. NCTA also supports combining inter and intrastate revenues; *see* NCTA Comments at 23 and 24.

35 *See* discussion *supra*.

36 See, *e.g.*, AirTouch Comments at 2-4; PCIA Comments at 9-12; Mobile Media Comments at 3-8; CTIA Comments at 4-8

37 *See* 47 U.S.C. § 332(c)(3).

national policy issue.[38] Indeed, problems of high-cost statewide service areas must be addressed at the federal level.

2. Local, as Well as Long Distance Services, Should Contribute Funding. Finally, several of the LECs argue that contribution should be raised only from interstate services or other-than-local services.[39] Fundamentally, the LECs are trying to build a system in which they collect subsidy revenues while others contribute them. There is no principled basis for doing this. As the LECs themselves point out, most local exchange customers should not be receiving subsidies.[40] Indeed, principles of both efficiency and fairness suggest that most local exchange customers should be contributing to universal service to assist those truly in need.[41]

CONCLUSION

Universal service reform is a critical piece of the puzzle as the Commission moves ahead to implement the 1996 Act and promote competition in all telecommunications markets. To maximize the benefits derived from telecommunications services, the Commission should design and implement programs that minimize waste in the payment of universal service support. Such programs include: (a) conducting impartial cost studies to estimate the true amounts of funding needed to support universal service, (b) making support flows explicit and accountable, (c) targeting subsidy payments, and

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38 *See* Comments of State of Maine Public Utilities Comm'n, *et al.* at 14.

39 *See e.g.*, BellSouth Comments at 15-16; Ameritech Comments at 23; GTE Comments at 16; PacTel Comments at 21; NYNEX Comments at 23-24.

40 *See e.g.*, Ameritech Comments at 8; Bell Atlantic Comments at 7-8; BellSouth Comments at 6

41 As discussed in Section II.B. above, a broader base will reduce the inefficiency of the tax collection. For a system of traffic-sensitive charges, a broader base allows lower per-unit charges and, hence, induces less distortion in consumption decisions.

(d) introducing competition into the process wherever possible. The Commission should also reform the collection of universal service support funds by raising the SLC to non-targeted end-users. Failing adoption of this policy, the Commission should levy a uniform per-minute surcharge on all retail telecommunications services. Lastly, the Commission should also ensure that there is a comprehensive and consistent national universal service policy.

Respectfully submitted,

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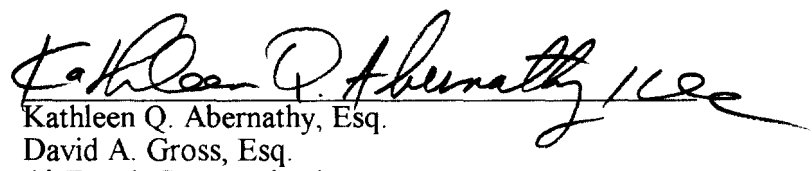
By: 

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May 7, 1996

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